

BUSINESS & LABOREXHIBIT NO. 1
DATE 1-28-09
BILL NO. SB 253

By Bob Miller, Owner
Bear Claw, McAllister

I started to evaluate the impact of Constitutional Initiative 151 on the restaurant businesses back in 2006 when it was placed on the Montana ballot.

What I wanted to analyze was how minimum wage, tips and taxes would be affected by the increase of the first \$1.10 in hourly wages to my wait staff, and further how the increase to \$7.25 would affect restaurant profitability looking ahead to July of 2009.

What I saw back in 2006 indicated that the health of the food service business in Montana through the coming three years was very much in doubt.

I have a background in statistics so I would like to take you through the math that brought me to these conclusions in 2006. Let's start with just the wage increase, then we can look at the interaction with tips and taxes.

First I determined my total "wait hours" per year. A wait hour is the number of wait staff on the floor per hour. If you have three wait staff on the floor for one hour then you have three wait hours.

In my case I determined that I have 8008 wait hours across the 364 days that we are open. Therefore, in 2006, the math was easy: the total wage increase, with the first boost of \$1.10 per hour, would amount to \$8,808.80 per year.

This is a good point to briefly look at the profit structures of the average casual dining restaurant. The national average for this type of business is a pre-tax bottom-line profit of between 5 percent and 10 percent.

Montana has a higher minimum wage for tipped employees than 43 other states. So it would be unlikely for a restaurant in Montana to post a 10 percent profit since we have one of the highest wait staff wages in the country. Therefore the increase to \$6.25, then \$6.55, \$6.90 and soon to be \$7.25 an hour is a very serious increase in labor cost that weighs heavy against the bottom line.

I looked at ways to try to mitigate the impact of these increases, things like cutting the time I bring my wait staff to work, reducing my total service staff per customer, increasing my per plate price and so on.

Without having to make a major change in my business model, I found my options were quite limited and most of the \$8,808.80 in new wages would have to come off the bottom line. That was just the first increase to \$6.25. I had not even projected out to 2009 yet.

My total wage increase by July 2009, to the \$7.25 an hour mandated by CI 151 for tipped employees, will be \$16,816.80 per year, even before the requisite increases in tax liability for both workmens compensation and unemployment that are linked to the wage, as well as federal

OVER →

Medicare and Social Security taxes.

This is a good time to consider the effect of tips.

Tips in Montana are taxable to the employer. That is the employer pays workmens compensation and unemployment taxes on all "declared tips."

What is a declared tip? All tipped employees, by law, are suppose to declare to their employer all tips that they receive. It is not the responsibility, in most cases, for the employer to determine the amount of these tips. Further, in Montana tips are tax exempt from state income tax, though declared tips are federally taxed as income.

Declared tips primarily are determined by the amount tipped on credit cards. As an example, consider a restaurant that has \$500,000 in annual sales. Typically, credit card sales may account for 50 percent of sales. Then you look at the average credit card tip. This number is very easy to determine and I have found it to be between 16 percent and 19 percent, depending on the given year

In this case, let's use the lower limit of 16 percent. Sixteen percent of \$250,000.00 (50 percent of total sales) is \$40,000 in tips per year. Using my figure of 8008 wait hours, that amounts to \$4.99 per hour for just credit card tips.

If you assume that people who pay with cash or check tip half as much - or 8 percent - there is another \$20,000 in annual tips.

Therefore \$60,000 in tips divided by 8008 wait hours is \$7.49 per hour. So looking on to July 2009, the average hourly income at my establishment for wait staff will be \$14.74 per hour.

In 2006, at \$5.15 an hour the average wait person made \$10.14 an hour with tips. This is using just the declared credit card tips. The employer pays social security and medicare just on the hourly wages, not on the tips. But in addition, the employer pays all work comp and unemployment taxes on the total amount, including on tips.

The increase in social security and medicare from just the \$5.15 to \$7.25 hourly increase amounts to \$1,286. The increase on work comp and unemployment amounts to another \$1,345 on average. This is just on the increase of the minimum wage and not considering any increase in the total amount of tips.

In addition, the employer pays a credit card fee, on average, of 3 percent on the credit card tips. It costs a restaurant another \$1,200 a year in credit card fees to process the \$40,000 of credit card tips for the wait staff, which that amount by law cannot be deducted from the employees' checks. Also by law, tips are the sole property of the employee and the employer must give the total amount of the tip to that employee regardless of any cost to the restaurant to furnish that tip.

You can see tips are a substantial additional cost to the restaurant and almost no cost to the wait person.

As of July 2009, looking at all the increases, tax liabilities and hourly increases, labor expenses increase by \$19,447.00. Assuming that we can maintain that theoretical 10 percent profit margin, which is doubtful, a business in McAllister will have to increase its total gross sales by \$194,470.00, just to account for this one wage increase. That would amount to around a 40 percent increase in sales, over three years!

The discussion above was all considered in 2006. The economy was buzzing along and casual dining was doing fine. The 2006 outlook was not necessarily healthy but the Legislature decided that all tips should remain taxed to the employer and that none of those tips should be counted toward the \$5.15 per hour, then \$6.25 per hour, soon to be \$7.25 hourly wage.

Since that time we have witnessed the largest economic downturn since the 1930's. We, as an industry, are mandated in the mist of a large decline in business to continue to give employees pay raises. The health of our businesses are declining rapidly and layoffs and closures are occurring every day.

Remember, the only time an employee has an opportunity to make untaxed tips is when the employer can afford to have the employee on the floor. When that cost per hour exceeds the profitability per hour, layoffs must occur.

Keep in mind all this is based on only the pay raise that has occurred for wait staff: no raises to cooks, dishwashers or bus people, all of which mostly make less than the wait staff and have a fully taxed paycheck. Is this fair? The forced and increasing wage disparities in these businesses is troublesome to employers and employees.

A restaurant in tiny McAllister is required, by law, to pay the same wage as a fine dining restaurant in Bozeman, or a large corporate operation in Billings. The gross sales of smaller rural restaurants cannot support the hourly overhead to remain open for breakfast, lunch and dinner. It is very difficult to realize sales revenues for breakfasts and lunches that cover that overhead. Raising prices enough on breakfast and lunches to cover increases in wait staff cost overhead is impossible; the market won't bear it.

In addition most tips are based on ticket totals so increasing prices increases tips and the associated employer liabilities! In a declining economy, with huge increases over the past three years in food costs, energy costs and now wages, smaller operations have been forced to severely limit their operations, or in some cases to eliminate some meals or some hours of operation completely.

This is the reality of 2009. Look forward to 2011 and beyond and what do we see? At some point the economy will begin to recover. Most economists believe that when the recovery occurs inflation will follow. The 2006 minimum wage initiative included an automatic cost-of-living increase on the minimum wage based on the Consumer Price Index (CPI). Once inflation sets in minimum wage could climb exponentially. At 7 percent inflation per year, a \$7.25 wage will rise to \$7.76; the following year to \$8.31... Well you get the idea.

OVER →

All the time the employer is paying workmens comp and unemployment taxes on not only the wage but on the tips as well. And still, tips cannot be counted toward the fulfillment of paying required minimum wages.

For some of us \$6.25 was too much of an increase and we have already begun to change our operations; in my case, closing the dining room Monday through Thursday, and maybe having to close it completely until the tourists show back up in June.

Others were on the edge at \$6.55 and trying to hold it together. At \$6.90 (January 1) others will begin to contract, even the large corporate operations. Then at \$7.25 (July 1) and beyond with the current economic downturn... The outcome is terribly clear.

The unfortunate thing is the very people this was designed to help now have limited hours or no hours at all. Keep in mind Montana has the highest minimum wage in the United States for tipped employees, well above required federal wage for tipped employees.

Even the Federal government recognizes that tipped employees ought to be treated significantly different than the non-tipped minimum wage employee when it comes to taxes.

An untipped minimum wage employee is paid for the hours worked and if there is no work they make nothing. A tipped employee only has an opportunity to earn additional money if there are diners. Unfortunately those opportunities have now been significantly diminished.

Without a tip credit and/or tax relief, the economic health of the food service business in Montana and their thousands of workers is very much in question.

What will our Legislature do?

Editor's note: Bob Miller owns and operates the Bear Claw Bar and Grill in McAllister. He unsuccessfully ran for the Legislature in the 2008 primary election as a Republican. To contact Miller on this issue, phone 406-581-8438.

1.

Dear Senate Business and Labor Committee,

I am writing to testify via email and to express my opinions regarding minimum wage, tip credit, and Senate Bill No. 253. Having earned a bachelor's degree in business marketing at MSU, I had spent two years with Moonlight Basin and was laid off in October 2008; my position was Assistant to the Director of Resort Sales & Marketing. Like many Montanans, I have struggled to make ends meet over the last 6 months, collecting unemployment and working part time at the Bear Claw. While the tips were great, my shifts have just been cut down due to the state of the economy and increasing minimum wage.

Below I've presented tip calculations, with a start date of 12/11/08 through 1/23/09.

Credit card sales, tip percentage of credit card sales:

Number hours worked: 156.87

Total Credit Card Sales: \$5,230

Credit Card Tips: \$961.05 = 18.37%

Total Sales and tips per hour (credit card, cash, check tips):

Number hours worked: 156.87

\$9959.50 (cash, checks, and credit cards)

\$11.66/hour in tips (cash, check)

\$6.12/hour in credit card tips

Simply stated, as minimum wage has increased, the Bear Claw has been forced to reduce both staff and hours of service, thus decreasing my opportunity to work for a living.

I'd rather have the opportunity to make great tips as presented above than not able to be on the floor of at all. This continuous increase in minimum wage for tipped employees is not affordable to the average, smaller business owners of Montana. Such tax and wage increases force them to decrease their staff numbers, thus more of us are out of work and not earning a living.

Thank you for your time and consideration.

Teresa Darby